IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1544

JOYCE BEVERAGES, INC., JOHN M. JOYCE
and WILLIAM J. COLLIER,

Petitioners,

vs.

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MICHAEL LESCH
SHEA GOULD CLIMENKO & CASEY
330 Madison Avenue
New York, New York 10017
Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel

MICHAEL LESCH,
SANFORD A. BELL.

INDEX

Table of Authorities

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In this action brought under the Securities Exchange Act of 1934 (the "1934 Act"), petitioners Joyce Beverages, Inc. ("JBI"), John M. Joyce and William J. Collier request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit (Hays and Friendly, J.J.; Oakes, J., dissenting) reversing in part the order of the United States District Court for the Southern District of New York (Judge Milton Pollack) dismissing the complaint herein upon petitioners' motion pursuant to Rule 12(b)(6), Federal Rules of Civil Procedure.

OPINIONS BELOW

The opinion of the Court of Appeals has not been reported at this time (2a).[1] Judge Pollack's memorandum decision and order, dated April 28, 1977, dismissing the complaint herein is reported at 430 F.Supp. 676 (12a).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered January 30, 1978 (1a).[2] This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether the Second Circuit's decision holding that the misrepresentations and omissions alleged in the complaint herein are actionable under the 1934 Act, contravenes the decision of this Court in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), will greatly increase the volume of meritless securities litigation in the federal courts and will transform proxy statements into "avalanche[s] of trivial information" (*id.* at 448)?

2. Whether the Second Circuit's decision creates a conflict with decisions of the Third and Fifth Circuits which must be resolved by this Court?

STATUTES AND RULES INVOLVED

Securities Exchange Act of 1934, § 10(b), 15. U.S.C. § 78j(b) (26a).

1. Numbers in parentheses followed by "a" refer to pages in the Appendix, *infra*, to this Petition. References herein to "JA" refer to the separate one volume Joint Appendix in the Court of Appeals. which has been filed together with this petition with the Clerk of this Court.

2. Petitioners' application to the Court of Appeals for the Second Circuit for a two-day enlargement of the time to file a petition for rehearing and suggestion for rehearing in banc was denied.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (26a).

Federal Rules of Civil Procedure, Rule 12(b)(6) (27a).

STATEMENT OF THE CASE

The complaint herein, filed on December 29, 1976, is purportedly based upon a transaction (the "Exchange") consummated on April 30, 1973, pursuant to which four "Seven-Up" bottling companies (collectively, the "operating companies") were consolidated through an exchange of the shares of those operating companies for shares in defendant JBI. Each shareholder of the operating companies was sent (1) a letter of acceptance containing the offer ("Letter") (2) an Agreement and Plan of Reorganization ("Agreement") and (3) an Information Statement. Copies of these were annexed to the complaint.

Plaintiffs are members of the same family as the principal defendant, John M. Joyce. Prior to the Exchange, plaintiffs owned various percentages of the outstanding shares of the operating companies and, after the Exchange, owned 37% of the stock of JBI. There is no claim that the amount of JBI stock received by plaintiffs was insufficient or unfairly calculated.

Plaintiff William J. Joyce was Chairman of the Board of two of the operating companies and is presently a director and the largest single stockholder of JBI. Defendant John M. Joyce, was formerly Chairman of the Board of one of the operating companies and presently is Chairman of the Board of JBI. The other individual defendant is William J. Collier, a director of each of the operating companies and a director and General Counsel of JBI.

Plaintiffs' complaint (17a) asserts three counts, all of which are alleged to be based upon Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.

Count I of the complaint sets forth the preceding facts and alleges:

1. That defendant John M. Joyce and his family, defendant William J. Collier and Sidney P. Mudd (a) control JBI, (b) own or have owned not less than 47.56% of JBI's outstanding common stock, (c) have never occupied fewer than a majority of the seats on JBI's Board of Directors, and (d) have at all times acted in concert in voting their shares (¶5 at 19a); and

2. That plaintiff William J. Joyce "relied upon the judgment" of John M. Joyce and William J. Collier "in all matters of consequence dealing with the affairs of JBI," and that William J. Collier served as the personal attorney for William J. Joyce until approximately June 1, 1976 (¶6 at 20a).

Count I then alleges that the Information Statement was misleading in that it contained three misstatements or omissions of material fact. The first was an alleged omission to state the purported purpose of the Exchange (¶10(a) at 21a). Both courts below held that this alleged omission did not state a claim and hence it is not before this Court.[3] The remaining two alleged omissions or misstatements—relating to Securities and Exchange Commission Rule 144 (17 CFR § 230.144) and the corporation law of the States of Illinois and Delaware—are discussed below.

Count II repeats Count I and adds that defendants John M. Joyce and William J. Collier were primarily responsible for the Exchange and for the Information Statement and that they knew or had reason to know that the Information

3. Plaintiffs alleged that the weakest of the operating companies was the one located in New York and that the primary purpose of the Exchange was to infuse capital into the New York operations through loans out of funds generated by the other operating companies (¶¶7-9 at 20a-21a). The Second Circuit agreed with the District Court that these allegations failed to state an actionable claim (8a).

Statement contained untrue statements and omissions of material fact (24a). Count III adds to Counts I and II the allegation that defendants John M. Joyce and William J. Collier caused the distribution of the untrue statements of material fact and omissions with intent to defraud the plaintiffs (25a).

Based on the above allegations, plaintiffs demand rescision of the Plan of Exchange and damages in an unspecified amount (25a-26a).

Nowhere have plaintiffs attacked the fairness of the Exchange and thus allege no financial injury. The present action was commenced three years and eight months after completion of the Exchange (25a) and is one of a number of lawsuits filed by plaintiffs against defendants in various jurisdiction in a far-ranging intra-family dispute having no real relationship to the federal securities laws.[4]

A. Rule 144

The first of the two allegations as to misleading statements upheld by the majority of the Second Circuit was an alleged omission to advise the plaintiffs that Rule 144 would not be "available as an exemption from the registration requirements of the Securities Act of 1933" if JBI did not make available certain information required under Rule 15c2-11 of the Securities Exchange Act (¶10(b) at 21a-22a).

Notwithstanding the foregoing allegations, the Information Statement, which appears as Exhibit B to the complaint (JA35), states with respect to Rule 144:

4. This Court may take judicial notice of the following other actions now pending between the two branches of the Joyce family: *Jill Kasselman* v. *Joyce Beverages, Inc., et al.* (U.S.D.C. N. Dist. Ill.) (76-C-4417); *William Joyce, Jr.* v. *Joyce Beverages, Inc., et ano* (U.S.D.C. N. Dist. Ill.) (76-C-4328) wherein a counterclaim has been interposed by defendants; and *William J. Joyce, Jr.* v. *James T. Norris, et ano* (Circ. Ct. Will Co. [Ill.] 12th Dist.) (76-G-3374L). All of the foregoing actions were commenced in 1976, the same year that the present action was commenced. The last-cited action, a libel action, was voluntarily dismissed with prejudice and with costs against William J. Joyce, Jr., one of the respondents in this case.

"Shares of common stock of Joyce [JBI] received by stockholders of the Companies pursuant to the Plan must be held indefinitely unless they are subsequently registered under the Act or an exemption from such registration is available. Rule 144 under the Act permits resale of shares so restricted to be made in limited quantities after the shares have been beneficially owned for two years in accordance with the terms and conditions of that Rule. Stockholders should consult their investment advisors for detailed information as to the operation and availability of Rule 144." (JA56)

In addition, the following facts relating to Rule 144 were disclosed in the Agreement (annexed to the Complaint as Exhibit A; JA13-28) and the letter (contained in Exhibit B annexed to the Complaint; JA29-32) which was required to be signed by every shareholder who wished to exchange his stock for JBI stock as provided by the Agreement:

(a) Both the Agreement and the Letter stated that "any routine sales of securities made in reliance on Rule 144 promulgated by the Securities and Exchange Commission under the Act can be made only in limited amounts in accordance with the terms and conditions of that rule and that, in the case of securities to which that rule is not applicable registration under the Act or the availability of another exemption therefrom will be required." (JA30, JA21)

(b) Both the Agreement and the Letter provided that all shares of JBI would bear a legend that they "have not been registered under the Securities Act of 1933, as amended, and none of such shares can be sold, transferred or otherwise disposed of in the absence of an effective registration statement under such Act or an opinion of counsel satisfactory to the issuer that registration under such Act is not required for such sale, transfer or other disposition." (JA24, JA31)

(c) Both the Agreement and the Letter provided that each of the stockholders represented that he was "acquiring all of the shares of [JBI] pursuant to the Plan for investment for the personal account of such Stockholder and not with a view to the distribution on resale of any such shares." (JA20, JA30)

(d) Both the Agreement and the Letter provided that resale of the JBI shares was prohibited unless, prior to such resale, the stockholder (1) gave written notice to JBI of his intention to sell shares, and (2) included with the notice a copy of a *bona fide* third party offer to purchase the shares. It was further provided that the foregoing operated as an offer to sell the shares to JBI on the same terms as the third party offer and that such offer to JBI remained open for 60 days (JA21-22, JA30).

Referring only to the Information Statement and ignoring the above-cited portions of the Agreement and Letter, the majority of the Court below held that the complaint stated a claim of an alleged misleading statement (8a). We respectfully submit that when the above-cited statements are read together with the Information Statement, there was no basis for the majority's decision (applying an incorrect standard of law) that a "reasonable shareholder" (a) "could" have attached importance to a Rule 144 exemption, or (b) "could" have believed that Rule 144 would be available to him.

B. Delaware Corporation Law

The remaining allegations of omissions or misleading statements are the alleged failure to disclose that rights appurtenant to the stock of the operating companies under Illinois law, would materially differ in the following four respects from rights appurtenant to the stock of JBI under

Delaware law: (1) the number of shares required to approve certain corporate actions, (2) the manner of filling vacancies in corporate boards of directors, (3) the rights of dissenting shareholders, and (4) the rights of indemnification of officers and directors (¶10(c) at 22a).

The complaint is devoid of any allegation which indicates how the alleged hypothetical differences between Illinois and Delaware Corporation Law are related to the facts of this case in any way, nor does the complaint allege or suggest that any action was planned or subsequently occurred which would be affected by any such alleged difference.

In particular, there was no allegation of a sale or other disposition of assets which required a vote such as that referred to in Paragraph 10(c)(1) of the complaint, or an appraisal procedure such as referred to in Paragraph 10(c)(3) of the complaint. Nor was there any allegation of a vacancy on the Board of Directors or of an event making the indemnification provisions of Delaware Corporation Law applicable, which might conceivably make the allegations of Paragraphs 10(c)(2) and 10(c)(4) of the complaint relevant. Thus, the alleged differences between Illinois and Delaware Corporation Law were—for aught that was set forth in the complaint—unrelated to any facts alleged in this case.

Judge Pollack, based on a careful analysis of the complaint and decisions from three different circuits—*Ash* v. *LFE Corp.*, 525 F.2d 215, 220 (3d Cir. 1975); *Vohs* v. *Dickson*, 495 F.2d 607, 625 (5th Cir. 1974); *Nanfito* v. *Tekseed Hybrid Co.*, 341 F.Supp. 240, 243, 245, (D.Neb. 1972), *aff'd*, 473 F.2d 537 (8th Cir. 1973)—concluded that there was nothing misleading whatsoever and dismissed the complaint.

On review, a divided Second Circuit affirmed Judge Pollack's dismissal of the complaint as a matter of law with respect to the first allegedly misleading statement, but

reversed the District Court with respect to the second and third statements. The majority opinion noted that these two statements raised "substantial issues".

Applying a standard repudiated by this Court's *Northway* decision, the Second Circuit held that the Information Statement's reference to Rule 144 "*could have misled* the reasonable shareholder" into thinking that the Rule was available to him (8a, emphasis added). Likewise, the Court opined that the reference to the distinction between Delaware and Illinois law, "*could* have misled" the reasonable shareholder into thinking that his legal rights were otherwise identical (*id.*, emphasis added). The "difficult question of materiality", Judge Hays concluded, "should not ordinarily be disposed of on a Rule 12(b)(6) motion (9a)."

Judge Oakes, dissenting in part, voted to affirm Judge Pollack with respect to all three statements as a matter of law (9a-11a).

REASONS WHY THE WRIT SHOULD BE GRANTED

A. The Majority's Decision Below Flatly Contravenes This Court's Decision in *TSC* v. *Northway*, Will Greatly Increase the Volume of Meritless Securities Litigations in the Federal Courts and (Unless Overturned) Will Transform Proxy Statements Into "Avalanche[s] of Trivial Information" Thereby Subverting the "Informed Decision-Making" the Securities Laws Are Designed To Foster (426 U.S. at 448-9).

In the recent case of *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), this Court was called upon to define the standard of materiality required under the 1934 Act. It held that an omitted fact is material only if there is a "*substantial likelihood* that under all the circumstances,

the omitted fact *would* have assumed actual significance in the deliberations of a reasonable shareholder" (emphasis added). In so holding, the Court rejected a standard of materiality grounded on "a fact which a reasonable shareholder *might* consider important".

This Court's rationale for adopting a limited notion of materiality was clearly stated as follows (426 U.S. at 448-9):

> "We are aware . . . that the disclosure policy embodied in the proxy regulations is not without limit. See *id.*, at 384. Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking."

In contravention of this cautionary principle, the majority's decision in the Second Circuit herein virtually precludes the dismissal of any complaint purportedly brought under Section 10(b) of the 1934 Act which alleges the conclusion that there have been misstatements or omissions of material facts, no matter how remote the likelihood that the shareholder was actually misled.

The Second Circuit's decision states the bald conclusion that the alleged misleading statements and omissions "raise substantial issues" (but nowhere articulates what those hypothetical substantial issues may be) and then holds broadly that "the difficult question of materiality should not

ordinarily be disposed of on a Rule 12(b)(6) motion" (9a).

The majority's decision in effect, signals to a prospective litigant that the mere allegation of misstatements or omissions of facts, however trivial, will guarantee him the right to extensive pre-trial procedures and eventual trial. This cannot fail to stimulate a flood of litigation of marginal and frivolous claims which will be measured more by their potential settlement value than by their merit. Such a result will directly undercut the policies limiting the unbridled expansion of litigation under the federal securities laws enunciated by this Court in its recent decisions in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 747-748 (1975), *reh. denied*, 423 U.S. 884 (1975); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), *reh. denied*, 425 U.S. 986 (1976); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977); and *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977).

Moreover, unless overturned, the majority's decision will engender a very real fear among business managements of exposing themselves to substantial liability and unwarranted legal expenses and will result in precisely the "avalanche of trivial information" which this Court sought to stem in *Northway* and which can only subvert the "informed decisionmaking" which this Court noted the securities laws are designed to foster (426 U.S. at 449).

Paradoxically, the significance of the Second Circuit's decision below and the importance of its review by this Court, derive from the very triviality of the allegations of misstatements and omissions on which plaintiffs' purported claim is based. If the federal securities laws can be freely invoked as a tactical device in an intra-family corporate squabble by merely hypothetical allegations of non-disclosure, the federal policy of informed disclosure in stockholders' affairs and transactions will be destroyed.

Not only does the practical result of the majority's decision below contravene the principles of *Northway*, but it appears that the Court below (although professing to apply a uniform standard of materiality) applied a different and lesser standard of materiality expressly rejected by this Court in *Northway*. Thus, the Second Circuit's majority decision correctly stated that the issue was whether the allegedly undisclosed facts, "had they been disclosed, *would* have been considered by the reasonable shareholder to have significally altered the 'total mix' of information made available" (8a). However, when it came to apply the standard, the majority of the Court below sustained the actionability of plaintiffs' claims of misstatements and omissions on the suggestion that they merely "could" have misled plaintiffs under some conceivable set of facts (9a). Nowhere does the Second Circuit suggest how these alleged misstatements and omissions *would* have assumed actual significance in the deliberations of the reasonable shareholder.

This Court's *Northway* decision made crystal clear its rejection of a materiality standard focusing on facts which a reasonable stockholder "might" consider important as a formulation "too suggestive of mere possibility, however unlikely" (426 U.S. at 449). It stated:

> "The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: An omitted fact is material if there is a *substantial likelihood* that a reasonable shareholder *would* consider it important in deciding how to vote. This standard is fully consistent with *Mills'* general description of materiality as a requirement that 'the defect have a significant *propensity* to affect the voting process.' It does not require proof of a *substantial likelihood* that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a *substantial likelihood* that, under all the circumstances, the omitted fact *would* have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a *substantial likelihood* that the disclosure of the omitted fact *would* have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." (426 U.S. at 449; emphasis added)

Yet the opinion of the majority below, with respect to both allegations of Section 10(b) violations applied the broader standard of materiality flatly rejected by this Court in *Northway*. The Second Circuit stated (9a):

> "The statement about the potential availability of Rule 144 *could* have misled the reasonable shareholder into thinking that it was, in fact, available to him. Similarly, the discussion of the loss of preemptive rights and the discontinuance of cumulative voting as a result of the changeover to Delaware law, *could* have misled him into thinking that the changeover did not otherwise affect his rights." (emphasis added)

It is possible that the Second Circuit's decision stems from a misreading of this Court's admonition in *Northway* that the determination of materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and those assessments are pecularly ones for the trier of fact" (426 U.S. at 450, quoted by the Second Circuit at 8a). However, this Court also made clear that the foregoing comments were directed to a case where the complaint clearly stated an actionable claim and the only question was whether summary judgment

against defendant was appropriate. Thus, this Court stated (426 U.S. at 450):

> "Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment."

Here, the question is not whether summary judgment foreclosing a defendant from the opportunity to present mitigating factors to the trier of fact is appropriate. Rather, it is whether the standards of materiality set forth by this Court in *Northway* must also be applied at the pleading stage. It appears that this Court's admonition concerning the "delicate assessments" that must be made by a trier of fact was read by the majority below as a foreclosing pre-trial dismissal of substantially all claims based on alleged misstatements or omissions, no matter how trivial the claims or how remote the likelihood that the shareholder was actually mislead. We submit that this Court never intended such a result and that the lower court's misapprehension runs directly contrary to the explicit rejection in *Northway* of a standard of liability that would cause "an avalanche of trivial information".

Because of the significant concentration of actions under the securities laws within the Second Circuit and the influence of the Second Circuit in this area in other jurisdictions, it is particularly important that this Court take affirmative action to signal that the Second Circuit's disregard of the *Northway* standard will not be ignored. No benefit can be derived from allowing this issue to percolate in the lower courts.

B. The Second Circuit's Decision Is in Conflict With Decisions of the Third and Fifth Circuits and That Split of Authority Should Be Resolved by This Court.

One reads the Second Circuit's decision in vain for any mention of the three cases cited by the District Court in support of its decision that plaintiffs' complaint should be dismissed: *Ash* v. *LFE Corp., supra; Vohs* v. *Dickson, supra; Nanfito* v. *Tekseed Hybrid Corp., supra.*

In those cases, the courts held alleged misrepresentations or omissions virtually identical to those alleged here to be nonactionable. In *Ash,* a unanimous panel of the Third Circuit noted that (525 F.2d at 220):

> "No case has been called to our attention requiring disclosure of speculative issues of state corporation law in a proxy solicitation."

And in *Vohs,* a unanimous Fifth Court panel held (495 F.2d at 625):

> "Rule 10b-5 cannot be construed to require a prospective seller of securities to give his prospective buyers legal advice on technical matters arising under the federal securities laws."

Also, *see Nanfito* v. *Tekseed Hybrid Corp., supra,* at 243, 245, *aff'd,* 473 F.2d 537 (8th Cir. 1973).

In this case, however, the Second Circuit held that once plaintiffs alleged that defendants mentioned the existence of Rule 144 and certain differing rights of shareholders pursuant to Delaware and Illinois law, they opened a Pandora's Box—the issue of "materiality"—which the Court believed could not be closed prior to a jury trial.

Since this decision invites the perception that, by merely alleging a misleading statement or omission under the securities laws, a plaintiff can compel a corporation to defend a lawsuit on its merits, corporate managers are likely to interpret the Second Circuit's decision as requiring them to provide shareholders with a fullblown exigesis of every issue of law which may conceivably bear upon the interests of shareholders. The resulting torrent of information will only interfere with intelligent decisionmaking. Since the concentration of the securities industry in New York City makes the Districts of the Second Circuit at least a potential venue in a great many types of actions under the federal securities laws, the nationwide impact of the Second Circuit's opinion must not be discounted.

The lack of a uniformly recognized test of disclosure with respect to legal matters conflicts with the federally mandated duty of regulated corporations to provide information to shareholders on a nationwide basis. This Court's enunciation of a uniform standard would eliminate the current posture of conflict among the Circuits in which the determination of whether the statements of a national corporation are actionable because of material misstatement and omissions may depend on the choice of forum.

Finally, it is very important that this case be heard at its present stage. If this case is tried on its merits, defendants are convinced that they will succeed. Therefore, the question of whether the allegations of plaintiffs' complaint are sufficient even to state a claim will never be presented to this Court. However, the damage the Second Circuit's decision is likely to cause will continue unabated. If corporate managers believe that an allegation of a material misrepresentation or omission is sufficient that the issue be tried, they will continue to "bury" their shareholders

with utterly useless verbiage—an unfortunate result which is incompatible with informed decisionmaking. In short, to allow this issue to percolate further in the lower Courts would only harm the investing public without promoting any significant policy of judicial administration.

CONCLUSION

For the foregoing reasons, the Court should grant this petition for a writ of certiorari.

Respectfully submitted,

Michael Lesch
Shea Gould Climenko & Casey
330 Madison Avenue
New York, New York 10017
Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel

Michael Lesch,
Sanford A. Bell.

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirtieth day of January one thousand nine hundred and seventy-eight.

United States Court of Appeals Filed Jan 30 1978. A. Daniel Fusaro, Clerk, Second Circuit.

Present: HON. HENRY J. FRIENDLY, HON. PAUL R. HAYS, HON. JAMES L. OAKES, Circuit Judges,

77-7262

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE McMANUS, PAUL McMANUS, JILL JOYCE KASSELMAN and JUDITH LANG,

Plaintiffs-Appellants,

v.

JOYCE BEVERAGES, INC., JOHN M. JOYCE and WILLIAM J. COLLIER,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said District Court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellees.

A. DANIEL FUSARO, *Clerk*

By

Deputy Clerk

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 255—September Term, 1977.
(Argued November 2, 1977 Decided January 30, 1978.)
Docket No. 77-7262

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Plaintiffs-Appellants,

—against—

JOYCE BEVERAGES, INC., JOHN M. JOYCE and WILLIAM J. COLLIER,

Defendants-Appellees.

Before:

FRIENDLY HAYS and OAKES,

Circuit Judges.

Appeal from an order of the United States District Court for the Southern District of New York, the Honorable Milton Pollack, *Judge,* dismissing plaintiffs' claims under § 10(b) of the Securities & Exchange Act of 1934, 15 U.S.C. § 78j(b) (1971), for failure to state a claim upon which relief can be granted under Fed. R. Civ. P. 12(b)(6) and

for failure to plead with particularity the circumstances constituting a fraud as required by Fed. R. Civ. P. 9(b).

Reversed and remanded.

DONALD E. EGAN, Chicago, Ill. (Katten, Muchin, Gitles, Zavis, Pearl & Galler, Chicago, Ill., Lee Ann Watson, on the brief; Chadbourne, Parke, Whiteside & Wolff, New York, N. Y., of counsel), *for Plaintiffs-Appellants.*

MICHAEL LESCH, New York, N. Y. (Shea Gould Climenko & Casey, New York, N. Y., Lillian S. Weigert, New York, N. Y., of counsel), *for Defendants-Appellees.*

HAYS, *Circuit Judge:*

Plaintiffs-appellants appeal the dismissal of their complaint in an action brought under §10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b)(1971), and Rule 10b-5, 17 C.F.R. §240.10b-5 (1977).

The complaint alleged that an "Information Statement" that accompanied a proposed exchange of stock contained various material omissions and misrepresentations. The defendants moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6) and 9(b) for failure to state a claim upon which relief can be granted and for failure to plead with particularity the circumstances constituting the fraud. The district court granted the motion. *Joyce* v. *Joyce Beverages, Inc.,* 430 F.Supp. 676 (S.D.N.Y. 1977).

We find that the complaint sufficiently complies with the requirements of Fed. R. Civ. P. 9(b), and therefore proceed to a consideration of the other alleged deficiencies.

The plaintiffs are William J. Joyce and the members of his immediate family: his wife, children, and son-in-law. In March of 1973, they owned a large block of the stock of four companies ("Operating Companies") engaged in the business of bottling Seven-Up and other soft drinks. The defendants are John M. Joyce, William J. Collier, and Joyce Beverages, Inc. ("JBI"). John M. Joyce was the Chairman of the Board of the New York Operating Company. He is now the Chairman of the Board of JBI. William J. Collier, who formerly served as the personal attorney of William J. Joyce, is a director of JBI and also serves as its General Counsel. As General Counsel, he was responsible for the legal matters relating to the preparation of the documents used in the instant transaction. JBI is a Delaware corporation that was formed to serve as a holding company for the four Operating Companies. The complaint alleges that John M. Joyce and William J. Collier, together with John M. Joyce's immediate family and another, own and at all relevant times have owned not less than 47.56% of the outstanding stock of JBI, that they have controlled a majority of the board of directors of JBI, and that they have acted in concert so that they hold a controlling interest in the company.

A plan was developed to reorganize and consolidate the four Operating Companies through the device of a holding company. As noted above, JBI was formed for this purpose. Pursuant to this plan, JBI proposed to the stockholders of the Operating Companies that they exchange their stock for shares of JBI. The offer was made by mail. The package sent to each shareholder included a letter containing the offer, an Agreement and Plan of Reorganization setting out the terms of the exchange, and an "Information Statement." The Information Statement was a lengthy, wide-

ranging disclosure document akin to the form of proxy statement outlined in Schedule A, Item 14, which is required when §14 of the Securities Exchange Act is applicable. In response to this offer, plaintiffs exchanged their shares in the Operating Companies for JBI stock. According to the complaint, they now hold 37% of the outstanding stock of JBI.

All of the companies involved in this case have at all times been privately held. The four Operating Companies were incorporated in Illinois; JBI is a Delaware corporation. It is not disputed that the New York Operating Company was the weakest of the four. Nor is it disputed that this fact was adequately disclosed.

I

The complaint charges that there were three materially misleading statements in the Information Statement:

1. The first section of the statement delineated the reasons for the proposed consolidation. Essentially, it stressed the operating economies that would result from the consolidation of the four companies. It also stressed that the consolidation would produce a financially stronger entity that would be in a better position to obtain financing.

The plaintiffs allege that the real purpose of the consolidation was to benefit defendants' New York company, which, as everybody knew, was the weakest financially. They allege that the plan was to have JBI float loans to the New York company out of the funds generated by the other Operating Companies, "all to the detriment of the Operating Companies other than New York."

2. The Information Statement contained a section explaining that the exchanged JBI shares could not be resold since

they had not been and would not be registered. *Inter alia,* it advised that Rule 144, 17 C.F.R. § 230.144 (1977), would allow resale if its terms were met, and that the stockholders should consult their investment advisors about the availability of Rule 144. Plaintiffs claim that this statement was misleading in that it implied that a Rule 144 exemption might be available when defendants knew that was not so.

3. As noted above, the Operating Companies were Illinois corporations; JBI is incorporated in Delaware. The Information Statement described certain changes in stock rights effected by this changeover: the loss of pre-emptive rights [1] and the discontinuance of cumulative voting.[2] Plaintiffs claim that by listing some but not all of the changes, defendants misled them. Specifically, they claim that defendants should have included the fact that: several types of stockholder approval votes could be effected by simple majorities instead of two third votes as under Illinois law;[3]

1. The Illinois Business Corporation Act. *Ill.Ann.Stat.* ch. 32 § 157.24 (Smith-Hurd, Supp. 1977), recognizes the stockholders' common law pre-emptive right, *see Elward* v. *Peabody Coal Co.,* 9 Ill. App. 234, 132 N.E. 2d 549 (1956), to share pro-rata in any new issue of corporate stock so that their interest in the corporation will not be diluted. Delaware does not recognize such a right. *See Del. Code* tit. 8 §§ 157, 161 (1975).

2. The Illinois act makes cumulative voting mandatory, *Ill.Ann. Stat.* ch. 32 § 157.28 (Smith-Hurd 1954); under the Delaware Act it is permissive. *Del.Code* tit. 8 § 214 (1975). If cumulative voting is not provided for in the certificate of incorporation, each shareholder is only entitled to one vote for each share that he holds. *Id.* § 212.

3. Under Delaware law, the certfiicate of incorporation may be amended by a majority vote of the stockholders. *Del.Code* tit. 8 § 242(c)(1) (1975). Under Illinois law, a two thirds vote is required. *Ill.Ann.Stat.* ch. 32 § 157.33(c) (Smith-Hurd. Supp. 1977). The same is true with regard to approval votes for mergers and consolidations, *compare Del.Code* tit. 8 § 251(c) (Supp. 1976) *with Ill.Ann.Stat.* ch. 32 § 157.64 (Smith-Hurd 1954), and for dissolutions or sales, leases, exchanges, mortgages, or pledges of all or substantially all of the assets of the corporation. *Compare Del.Code* tit. 8 § 271(a) (1975) *with Ill.Ann.Stat.* ch. 32 § 157.76(c) (Smith-Hurd 1954).

These differences are of practical import in the instant case. The complaint alleges that, together, the plaintiffs owned more than one third of the stock of each Operating Company. This gave them an effective veto of any proposed merger, dissolution, or amendment of the charter. They lost this power when they exchanged their stock for stock in JBI, a Delaware corporation.

vacancies on the Board of Directors could be filled by the vote of the remaining directors instead of the stockholders;[4] certain appraisal rights would be lost;[5] and, under Delaware law, JBI's officers and directors would have broader rights of indemnification.

The district court held that, as a matter of law, none of these alleged misrepresentations or omissions was material. It understood the first claim to allege that the weakness of the New York company, and the fact that it stood to benefit by obtaining loans, was not adequately disclosed. The court held that it was not fraudulent to fail to say that the weakest company would benefit from the consolidation. It did not find anything misleading about the Rule 144 statement. With regard to the changes in stockholders' rights resulting from the change in states of incorporation, it held that the defendants' duty to disclose was discharged by the disclosure of the changeover and the inclusion of the names of the states involved. 430 F. Supp. at 678.

4. *Del.Code* tit. 8 §§ 142(e), 223(a) (1975). *Compare Ill.Ann. Stat.* ch. 32 § 157.36 (Smith-Hurd 1954).

5. In the event of a sale or exchange of substantially all of the assets of a corporation, the Illinois act provides for appraisal rights for the dissenting shareholders. *Ill.Ann.Stat.* ch. 32 § 157.73 (Smith-Hurd, Supp. 1977). The same is true in the event of a merger or consolidation. *Id.* § 157.70 (Smith-Hurd, Supp. 1977). The Delaware act provides for appraisal only in the event of a merger or consolidation. *Del.Code* tit. 8 § 262 (Supp. 1976), not in the event of sale or exchange.

While we agree with the district court's conclusions as to the first claim, we cannot go along with its views as to the materiality of the second and third claims.

II

On this motion to dismiss for failure to state a claim, plaintiffs' allegations must be accepted as true and must be read in the manner most favorable to them. This is especially true when dealing with questions of materiality which, since they are "mixed questions of law and fact," require

> delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.

TSC Industries, Inc. v. *Northway, Inc.*, 426 U.S. 438, 450 (1976).[6] The issue on this Rule 12(b)(6) motion is whether the plaintiffs can prove any set of facts that, had they been disclosed, would have been considered by the reasonable shareholder to have "significantly altered the 'total mix' of information made available." *Id.* at 449.

We cannot say that this is not the case with respect to the second and third claims here.

The statements about the availability of Rule 144 and the omissions regarding Delaware law raise substantial issues. The statement about the potential availability of Rule 144 could have misled the reasonable shareholder into thinking

6. *TSC Industries* dealt with the standard of materiality under § 14(a) of the '34 Act, 15 U.S.C. § 78n(a) (1971). However, it is generally agreed that the same standard applies under § 10(b). *See Goldberg* v. *Meridor*, No. 77-7146 at 5820-21 (2nd Cir. Sept. 8, 1977). This seems correct as a matter of statutory interpretation since the statutes are *in pari materia*. As a matter of policy, the *TSC* standard is particularly appropriate in this case since it involves an Information Statement much akin to a proxy statement in a merger vote.

that it was, in fact, available to him. Similarly, the discussion of the loss of pre-emptive rights and the discontinuance of cumulative voting as a result of the changeover to Delaware law, could have misled him into thinking that the changeover did not otherwise affect his rights.

III

Of course, we intimate no views on the merits of this case. It may develop that plaintiffs cannot demonstrate to the trier of fact that the reasonable shareholder would have been misled. It may develop, once discovery has begun, that the plaintiffs actually knew or could not have cared less about the very facts that they claim were misrepresented. We stress only that the difficult question of materiality should not ordinarily be disposed of on a Rule 12(b)(6) motion.

Accordingly, we reverse and remand for further proceedings not inconsistent with this opinion.

OAKES, *Circuit Judge* (dissenting):

I most respectfully dissent.

I agree with Judge Pollack below that none of the asserted omissions or representations is sufficiently material to avoid dismissal. I shall deal *seriatim* with the three statements alleged to be misleading.

First, the representation that a purpose of the consolidation was to permit financing to be obtained more easily and at lower cost is not a representation that the stronger companies' excess funds would not be used to strengthen the financial position of the New York Operating Company. Any consolidation implies to a reasonable stockholder, it

seems to me, that there will be intercorporate loans, quite likely from the stronger to the weaker entities of the consolidation. Excessive lending, charging an unreasonably low rate of interest or imperiling the stronger corporation's capital may give rise to a state cause of action for waste of assets or for mismanagement. However, as the majority and I agree, the omission to state that there will be such lending does not rise to the level of a 10b-5 claim.

Second, the reference to Rule 144, surely a boilerplate provision in the Information Statement, presents a somewhat closer question, but the statement issued did say that the shares of JBI "must be held indefinitely unless they are subsequently registered under the Act or an exemption from such registration is available." That was true, and it was followed by another true statement that Rule 144 permits resale of restricted shares in limited quantities after a holding period of two years "in accordance with the terms and conditions of that Rule." To my mind this language would put a reasonable shareholder on notice that unless "that Rule" were subsequently complied with,[1] he would have to hold them "indefinitely."

1. Compliance with Rule 144 is no simple matter. Under the rule, a seller of restricted securities will not be deemed a Section 2(11), 15 U.S.C. § 77b(11), underwriter, if *inter alia,* in addition to holding the securities for the requisite period. 17 C.F.R. § 230.144(d), and to complying with the applicable limitation on the amount of securities which may be sold, *id.* § 230.144(e), the issuer has made available adequate current public information with respect to itself. The issuer may satisfy the information requirement in either of two ways. It must have securities registered under either the Securities Exchange Act of 1934 or the Securities Act of 1933, thereby making itself subject to the reporting requirements of Sections 13 and 15(d) respectively of the 1934 Act, 15 U.S.C. §§ 78m, 78o, or it must have made publicly available the information required by Rule 15c2-11. 17 C.F.R. § 240.15c2-11(a)(4) (1977). *See* 17 C.F.R. § 230.144(c)(1), (2) (1977).

Finally, the reference to Delaware as the state of JBI's incorporation and to two Delaware corporate law provisions particularly burdensome on these minority stockholders—relating to lack of preemptive rights and unavailability of cumulative voting—was factually accurate. Such a reference should have alerted even the most unsophisticated stockholder to the possibility that Delaware law had additional, perhaps more esoteric traps for the unwary which, to avert, might well require advice of counsel. But I should have thought that it has long been a matter of common knowledge to the business world generally that Delaware's corporation law quite generally favors management and controlling interests, and disfavors minority stockholders. To my knowledge, the SEC has not yet required merger information or proxy statements to bear a sticker warning against the laws of Delaware. More to the point, perhaps, no allegation in the complaint indicates that any of the Delaware laws *not* mentioned in the Information Statement here have in some way been utilized by the controlling interests adversely to those of appellants.

I suspect that the proof may show that appellants received poor legal advice when they went into the exchange of stock. This might give them a state cause of action for negligence or other breach of fiduciary duty if, since allegedly their attorney benefited from the transaction, indeed, appellants have suffered loss. But I agree with Judge Pollack that the Information Statement does not give rise to a cause of action under federal securities law, and accordingly would affirm.

APPENDIX C

UNITES STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

76 CIV. 5846(MP)

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Plaintiffs,

v.

JOYCE BEVERAGES, INC., JOHN M. JOYCE and WILLIAM J. COLLIER,

Defendants.

DECISION

Milton Pollack, District Judge.

Defendants move, pursuant to Fed. R. Civ. P. 12(b)(6) and 9(b) for a dismissal of the complaint for failure to state a sufficient claim for relief and failure to plead with particularity any circumstances constituting fraud.

On April 30, 1973 plaintiffs exchanged their common stock in four "Seven-Up" bottling companies ("Operating Companies") incorporated in the State of Illinois for shares in Joyce Beverages, Inc. ("JBI") incorporated in the State of Delaware, pursuant to an Agreement and Plan of Reorganization.[1] The offer for the exchange was made by mail, and was accompanied by a document labeled "Information Statement". Having been annexed to the complaint, that may be considered hereon. Wright & Miller, *Federal Practice and Procedure:* Civil § 1357 at 604.

1. This suit was filed three years and eight months after the exchange in which plaintiffs participated fully. Plaintiff William J. Joyce became and is a director and largest stockholder of JBI.

Plaintiffs seek rescission of the exchange and damages on the ground that the offer omitted and misstated material facts with intent to defraud the plaintiffs in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

Material omissions charged

1. That: the Information Statement failed to say that the New York Seven-Up Bottling Co., one of the four operating Companies was financially weaker than the other three; that the Chairman of the Board of Directors, defendant John Joyce, and the General Counsel of JBI, defendant William Collier, who also was a director of JBI and of the Operating Companies, intended by the Plan to facilitate JBI loans to the New York company out of funds generated by the other Operating Companies.

2. That: the Information Statement suggested to the plaintiffs that Rule 144 of the General Rules and Regulations under the Securities Act of 1933 would be available to plaintiffs to market their JBI stock and such suggestion was incorrect because (a) JBI is not a registered company under the 1934 Act, and (b) JBI does not make public the information required by Rule 15C2-11 of the 1934 Act.

3. That: the Information Statement failed to disclose material differences between the rights of stockholders in Delaware and Illinois corporations in respect to (a) the percentage of votes required for approval of major corporate actions, (b) the manner of filling vacancies on the Board, (c) appraisal rights in connection with sale of cor-

porate assets, and (d) rights of indemnification of directors and officers for their corporate acts.

None of the asserted omissions or representations is sufficient to warrant entertaining this litigation.

The recitation in the Statement of the purpose of the Plan was, to reorganize the [Operating] Companies under common ownership in order to achieve economies in administration and permit greater strength and flexibility including the purpose to permit financing to be obtained more easily and at lower costs from the consolidated strength of the assets of the four Companies.

Since there was no representation in the Information Statement that the four Operating Companies had the identical financial strength, (indeed the financial data set out specifically indicated the contrary), it can hardly be claimed that it was fraudulent to fail to mention the obvious that the companies were of unequal strength and that the weakest would benefit from a consolidation with the other three.

The statement issued concerning Rule 144 which is as follows does not omit material fact nor does it contain material misstatement:

> Shares of common stock of Joyce (JBI) received by stockholders of the Companies pursuant to the Plan must be held indefinitely unless they are subsequently registered under the Act or an exemption from such registration is available. Rule 144 under the Act permits resale of shares so restricted to be made in limited quantities after the shares have been beneficially owned for two years in accordance with the terms and conditions of that Rule. Stockholders should consult their investment advisors for detailed information as to the operation and availability of Rule 144.

The corporate rights of stockholders provided for in statutes of the states of incorporation are adequately described by reference to the identity of the states involved. Where the names of the states of incorporation are set forth the reader is charged with constructive notice of the relevant statutes. The omission of a comparison thereof in an exchange offer is not an omission of matter on which a 10b-5 claim may be mounted for a recovery.

There is no duty to render legal advice to the reader of an exchange offer; an omission of legal advice is not fraudulent. *Vohs* v. *Dickson,* 495 F.2d 607, 625 (5th Cir. 1974). In *Vohs* v. *Dickson, supra,* an employee sold his unregistered stock in his corporate employer to a fellow employee. The purchasing employee claimed that the seller had violated 10b-5 by not advising her that the stock must be purchased with a non-distributive intent in order to escape the federal registration requirements upon a subsequent resale.

The Court rejected this claim, stating:

> Federal law makes it fraudulent to misrepresent or omit material *facts* in respect to a sale of securities.
>
> * * *
>
> The important point . . . is that whether or not plaintiffs had to take the stock with non-distributive intent is not a matter of fact—material or otherwise; it is a matter of law. *Rule 10b-5 canot be construed to require a prospective seller of securities to give his prospective buyers legal advice on technical matters* arising under the federal securities law. If the buyer is aware of the material facts— [unregistered stock]—he should be as aware of the *legal consequences* of those facts as his seller. Id. at 625. (Emphasis supplied)

Cf. Ash v. *LFE Corp.*, 525 F.2d 215, 220 (3d Cir. 1975). "No case has been called to our attention requiring disclosure of speculative issues of state corporation law in a proxy solicitation." *See also, Nanfito* v. *Tekseed Hybrid Co.*, 341 F. Supp. 240, 243, 245, (D. Neb. 1972), *aff'd*, 473 F.2d 537 (8th Cir. 1973).

The complaint is dismissed for insufficiency in the respects claimed in the notice of motion.

SO ORDERED.

MILTON POLLACK

April 28, 1977 ....

U.S. District Judge

APPENDIX D

COMPLAINT

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Plaintiffs,

—against—

JOYCE BEVERAGES, INC., JOHN M. JOYCE, and WILLIAM J. COLLIER,

Defendants.

Plaintiffs for their complaint herein allege:

1. This action arises under Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Rule 10b-5 of the General Rules and Regulations thereunder. This Court has jurisdiction under Section 27 of that Act (15 U.S.C. § 78aa).

COUNT I

2. On March 26, 1973, plaintiffs were owners of shares of stock in Chicago Seven-Up Bottling Co. ("Chicago"), Illinois Seven-Up Bottling Co. ("Illinois"), Madison Seven-Up Bottling Co. ("Madison"), and New York Seven-Up

Bottling Co. ("New York") (hereinafter collectively referred to as "Operating Companies") as follows:

	Chicago	Illinois	Madison	New York
William J. Joyce	5492	5492	2000	5492
Bernice Riley Joyce	267	267	40	267
Mary Joyce Hammond	380	380	80	380
William J. Joyce, Jr.	522	522	102	522
Dorothy Ann Joyce	92	92	0	92
Catherine Joyce McManus	423	423	80	423
Paul McManus	92	92	0	92
Jill Joyce Kasselman	393	393	80	393
Judith Joyce Lang	423	423	80	423

3. Plaintiffs are presently owners of approximately 37% of the total issued and outstanding shares of the common stock of defendant Joyce Beverages, Inc. ("JBI"). The number of shares of JBI common stock owned by each plaintiff is as follows:

Stockholder	No. of Shares
William J. Joyce	263,039
Bernice Riley Joyce	12,136
Mary Joyce Hammond	18,075
William J. Joyce, Jr.	25,283
Dorothy Ann Joyce	4,641
Catherine Joyce McManus	20,518
Paul McManus	4,641
Jill Joyce Kasselman	18,232
Judith Joyce Lang	20,518
Total	387,083

4. All or nearly all of plaintiffs' presently-owned shares of JBI were acquired on or about April 30, 1973, pursuant to an Agreement and Plan of Reorganization ("the Plan")

dated April 1, 1973, a copy of which is attached hereto and incorporated herein as Exhibit A. Pursuant to the Plan, each shareholder of an Operating Company was offered by JBI the right to exchange his shares in said corporation for the number of shares of JBI as set forth in Paragraph 3 of the Plan. The aforesaid offer was made by letter dated March 26, 1973, which was transmitted by United States mail to each shareholder of the Operating Companies with a document labeled "Information Statement". A copy of the Information Statement and the transmittal letter is attached hereto and incorporated herein as Exhibit B. The shares owned by plaintiffs, as set forth in paragraph 2 hereof, were exchanged for the number of shares of JBI set forth opposite each plaintiff's name in paragraph 3 hereof, in accordance with the provisions of the Plan.

5. JBI is controlled by defendant John M. Joyce, his wife, his descendants and their spouses, acting in concert with defendant William J. Collier, General Counsel of JBI, and Sidney P. Mudd, President of JBI. Such persons are hereinafter collectively referred to as "the Controlling Persons". John M. Joyce is Chairman of the Board of JBI, and as such is responsible for the supervision and direction of all of the business and affairs of JBI. William J. Collier is the General Counsel and a Director of JBI and each Operating Company, and as such was responsible for all legal matters relating to the preparation of the Plan and the Information Statement. The Controlling Persons own, or have at all times relevant hereto owned, in the aggregate not less than 47.56% of the outstanding shares of common stock of JBI and each Operating Company. The Controlling Persons at all times relevant hereto have occupied not less than a majority of the seats on the Board of Directors of JBI. The Controlling Persons have

at all times relevant hereto acted in concert with respect to the voting of their shares of JBI, and casting their votes at directors' meetings, and in the conduct of their duties as officers of JBI and the Operating Companies.

6. Plaintiff William J. Joyce is and at all times relevant hereto has been a director of JBI, largest single stockholder of JBI, and Chairman of the Board of Illinois and Madison. However, at all times relevant hereto he has not been actively involved in the day-to-day affairs of JBI and the Operating Companies. In all matters of consequence dealing with the affairs of JBI, he has until the summer of 1976 relied on the judgment of John M. Joyce and William J. Collier. Until approximately June 1, 1976, William J. Collier served as the personal attorney of William J. Joyce. The remaining plaintiffs are all members of the immediate family (spouse, children and a son-in-law) of William J. Joyce.

7. During the period prior to the consummation of the Plan, New York was financially weaker than the other Operating Companies, as evidenced by the following:

(a) New York operated on the smallest profit margins in relations to sales;

(b) New York had the least favorable ratio of total assets to total liabilities;

(c) New York had the least favorable ratio of current assets to current liabilities; and

(d) New York had the largest percentage of its total assets as fixed assets as opposed to current assets.

As a result of the foregoing, and other factors relating to New York's business, New York's need for capital and

financial support was the greatest among all of the Operating Companies.

8. As residents of the New York area, John M. Joyce and William J. Collier, both of whom were and are Controlling Persons, had a particular stake in the maintenance and expansion of New York at the expense of the other Operating Companies, and said individuals sought to enhance their individual positions within the corporate scheme by maintaining the overall corporate headquarters of all the Operating Companies in the State of New York.

9. Because of the considerations set forth in paragraphs 7 and 8, a primary purpose of John M. Joyce and William J. Collier in causing the Plan to be effected was to facilitate the infusion of outside capital into New York by loans from JBI to New York out of funds generated from the Operating Companies other than New York, all to the detriment of the Operating Companies other than New York.

10. The Information Statement is misleading in that it contains the following untrue statements of material facts or omissions of material facts necessary in order to make the statements made therein not misleading:

(a) On pages 1, 2 and 3, the Information Statement purports to state the purposes of the Plan. No disclosure is made as to the purpose alleged in paragraph 9 of this complaint.

(b) On page 19 of the Information Statement, it is stated that:

> Rule 144 under the [Securities] Act [of 1933] permits resale of shares so restricted to be made in limited quantities after the shares have been beneficially owned for two years in accordance with the terms and conditions of that Rule.

In fact, Rule 144 is not available and was not at the time of that statement available as an exemption from the registration requirements of the Securities Act of 1933 for companies not registered under the Securities Exchange Act of 1934 or companies which do not make public certain information required by Rule 15C2-11 of that Act. JBI is not and was not then so registered and, upon information and belief, JBI did not then and does not now intend to make such information publicly available. To the extent that plaintiffs had not exchanged their shares of the Operating Companies that they had acquired prior to June 15, 1972 for shares of JBI, the plaintiffs would have been entitled to sell their shares entirely free of the restrictions of Rule 144.

(c) Pages 20 and 21 of the Information Statement purport to describe the newly-issued capital stock of JBI offered under the Plan and to explain the differences between the stock of the Operating Companies which had all been organized under the laws of Illinois, and the stock of JBI which was organized under the laws of Delaware. No disclosure was made of the following material differences in the rights appurtenant to the stock of the Operating Companies and the rights appurtenant to the stock of JBI:

(1) As to all of the Operating Companies, a favorable vote of holders of two-thirds of the outstanding shares was required to approve a merger or consolidation, amendment of the Articles of Incorporation, dissolution or sale, lease, exchange, mortgage or pledge of all or substantially all the assets. Plaintiffs owned, in the aggregate, in excess of one-third of the outstanding shares of each Operating Company, and thus, acting collectively, would have held an effective veto power over any such action. Inasmuch as the Certificate of Incorporation of JBI and Delaware law permit any such action to be taken by a favorable vote of only a simple majority of the outstanding stock (and in some cases, without the approval of stockholders at all), the Plan has seriously affected the position of plaintiffs and reduced their influence in the corporate affairs of JBI.

(2) Any vacanies in the Boards of Directors of the Operating Companies can only be filled by a vote of the shareholders, but JBI can fill such vacanies by a vote of the remaining directors.

(3) Dissenting stockholders have no appraisal rights in connection with the sale, lease or exchange of substantially all the assets of JBI, but they had such rights as shareholders of the Operating Companies.

(4) Under Delaware law far broader rights of indemnification of JBI's officers and directors are permitted than existed for the officers and directors of the Operating Companies.

11. JBI knew or had reason to know that the Information Statement contained the untrue statements of material fact and omissions of material fact set forth in paragraph 10 hereof.

12. The conduct of JBI in connection with the Plan violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

13. As a consequence of the violations complained of herein, plaintiffs were induced to exchange their shares of the Operating Companies for the offered shares of JBI, and have suffered substantial monetary loss thereby in an amount not yet determinable.

14. The Controlling Persons approved and approve of the content of the Plan and Information Statement, and consequently any demands by plaintiffs on JBI for relief from the wrongs complained of herein would be futile.

COUNT II

15. Plaintiffs repeat and reallege the allegations contained in paragraphs 2 through 14 of this complaint.

16. Defendants John M. Joyce and William J. Collier were primarily responsible for the Plan and the preparation of the Information Statement.

17. John M. Joyce and William J. Collier know or had reason to know that the Information Statement contained untrue statements of material fact and omissions of material fact as set forth in paragraph 10 hereof.

COUNT III

18. Plaintiffs repeat and reallege the allegations contained in paragraphs 2 through 14 and in paragraphs 16 and 17 of this complaint.

19. John M. Joyce and William J. Collier caused the distribution of the untrue statements of material fact and omissions of material fact set forth in paragraph 10 hereof, with intent to defraud the plaintiffs.

Wherefore, plaintiffs demand judgment against defendants:

(1) in the amount of all damage suffered by the plaintiffs as a result of the conduct hereinabove described;

(2) permitting plaintiffs to rescind the exchange of their shares in the Operating Companies in return for all shares of Joyce Beverages, Inc. received by them; and

(3) for such other and further relief as to the Court may appear proper, together with the costs and disbursements of this action.

DEMAND FOR JURY TRIAL

Pursuant to Rule 38(b) of the Federal Rules of Civil Procedure, plaintiffs demand a trial by jury in this action.

December 28, 1976

Katten, Muchin, Gitles, Zavis,
Pearl & Galler
55 East Monroe Street
Suite 4100
Chicago, Illinois 60603
(312) 346-7400

Chadbourne, Parke, Whiteside
& Wolff

By Chester Hinshaw
A Member of the Firm
30 Rockefeller Plaza
New York, New York 10020
(212) 541-5800

Attorneys for Plaintiffs

APPENDIX E

Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b)

§ 78j. MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission, Rule 10b-5, 17 C.F.R. § 240.10b-5

§ 240.10b-5. EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange—

> (a) To employ any device, scheme, or artifice to defraud.
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

> in connection with the purchase or sale of any security.

Federal Rules of Civil Procedure, Rule 12(b)(6)

Rule 12.

DEFENSES AND OBJECTIONS—WHEN AND HOW PRESENTED—BY PLEADING OR MOTION—MOTION FOR JUDGMENT ON THE PLEADINGS

* * *

(b) *How Presented.* Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion. If a pleading sets forth a claim for relief to which the adverse party is not required to serve a responsive pleading, he may assert at the trial any defense in law or fact to that claim for relief. If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

In the

Supreme Court of the United States

October Term, 1977

No. 77-1544

JOYCE BEVERAGES, INC., JOHN M. JOYCE
and WILLIAM J. COLLIER,

Petitioners,

vs.

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE McMANUS, PAUL McMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENTS IN OPPOSITION.

Donald E. Egan,
Lee Ann Watson,
Katten, Muchin, Gitles,
Zavis, Pearl & Galler,
55 East Monroe Street,
Suite 4100,
Chicago, Illinois 60603,
(312) 346-7400,
Attorneys for Respondents.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

INDEX.

Table of Authorities.

Cases.

In the

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OPINIONS BELOW.

The opinion of the Court of Appeals for the Second Circuit, which was not reported at the time the Petition was filed, is reported at 571 F. 2d 703 (2d Cir. 1978) (2a).[1]

1. Numbers in parenthesis followed by "a" refer to pages in the Appendix attached to the petitioners' brief.

QUESTION PRESENTED.[2]

Whether plaintiffs' Complaint states a claim upon which relief can be granted under the Securities Exchange Act of 1934 in alleging that a disclosure document accompanying a stock exchange offer to shareholders contained materially misleading statements with respect to the potential availability of Rule 144 and omitted certain material information with respect to changes in shareholders' rights which was necessary to make other statements not misleading?

STATEMENT OF THE CASE.

Contrary to Supreme Court Rule 40, much of the defendants' Statement of the Case is argumentative,[3] particularly in relation to the misleading statements upon which the plaintiffs base their claim. (Petition, pp. 7-9.) Such statements are clearly inappropriate in the Statement of the Case and accordingly will not be addressed by plaintiffs. Rather this Statement of the Case will be confined to a correction of the omissions and inaccuracies of that of defendants. *See* R. STERN & E. GRESSMAN, SUPREME COURT PRACTICE, §§ 6-44, 11-9 (3d ed. 1962).

Defendants incorrectly assert that one of plaintiffs' claims of a misleading statement stems from an "omission to advise the plaintiffs that Rule 144 would not be 'available as an exemption from the registration requirements of the Securities Act of 1933' if JBI did not make available certain information required under

2. Contrary to Supreme Court Rule 23(c), defendants have not stated the question presented for review, but rather rephrased the considerations which they contend support the issuance of a writ of certiorari. *See* R. STERN & E. GRESSMAN, SUPREME COURT PRACTICE, § 6-42, at pp. 248-249 (3d ed. 1962). Plaintiffs have accordingly set forth the actual issue which the Court is requested to review if it issues the writ.

3. The tenor of defendants' approach is illustrated by their gratuitous and irrelevant reference to other litigation between members of defendants' and plaintiffs' families.

Rule 15c2-11 of the Securities Exchange Act." (Petition, p. 5.) In fact, as the Complaint clearly demonstrates, and as the court of appeals recognized,[4] plaintiffs' claim is that the Information Statement was misleading because of the ambiguous statements concerning the potential availability of Rule 144 when Rule 144 was not in fact available to JBI stockholders. (Complaint, ¶ 10 (b), 21a-22a.)

With respect to the second claim of misleading statements, defendants again inaccurately describe the plaintiffs' position. Plaintiffs do not contend, as defendants assert, that the Information Statement is misleading for failing to disclose that rights appurtenant to the stock of the operating companies under Illinois law would materially differ in four particular respects from rights appurtenant to the stock of JBI under Delaware law. (Petition, p. 7.) Rather, the plaintiffs' Complaint alleges that the Information Statement was misleading as a result of its purported description of the newly-issued capital stock of JBI. (Complaint, ¶ 10c, 22a.) The Information Statement affirmatively revealed certain shareholders' rights that would be affected, but no disclosure was made of other material differences in rights appurtenant to the stock of the operating companies and rights appurtenant to JBI stock which could have adverse consequence for plaintiffs.

Defendants' Statement of the Case also discusses matters that the Complaint does not allege, stating as follows:

> The complaint is devoid of any allegation which indicates how the alleged hypothetical difference between Illinois and Delaware Corporation Law are related to the facts of this case in any way, nor does the complaint allege or suggest that any action was planned or subsequently occurred which would be affected by such alleged difference.

(Petition, p. 8.) This statement is not only argumentative, but it is totally specious. Hindsight may, of course, be illuminating, but it is absolutely irrelevant to this action in which plaintiffs

4. *See* 571 F. 2d at 705, 707 (6a, 8a).

seek relief pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b) (1970). Plaintiffs need not establish what occurred subsequent to the illegal securities transaction since the crux of a Section 10(b) action is the use of any manipulative or deceptive device in connection with the purchase or sale of security.[5] If defendants' position had any merit it would mean that a valid Section 10(b) claim could never arise until it is possible to determine whether the undisclosed event actually occurs. Such a result is totally at odds with the purpose of the securities laws.[6]

Perhaps the most crucial omission in the defendants' Statement is the failure to recite the procedural posture of this case and to note the Second Circuit's limited holding in light of that posture. The case is not at issue. Rather the defendants filed a Motion to Dismiss pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure for failure to state a claim upon which relief can be granted and for failure to plead with particularity the circumstances constituting fraud. District Court Judge Milton Pollack granted that motion under both Rules.[7] On appeal the Second Circuit held that plaintiffs' Complaint complies with the requirements of Rule 9(b) and that plaintiffs' second and third allegations of misleading statements constitute valid claims which, if proven, warrant relief being granted to plaintiffs. The Second Circuit expressed no view on the merits of this case, properly noting it would be premature to do so, and that the question of "materiality should not ordinarily be disposed of on a Rule 12(b)(6) motion". 571 F. 2d at 707.

5. *See Rochelle* v. *Marine Midland Grace Trust Co.*, 535 F. 2d 523, 532 (9th Cir. 1976); *Tomera* v. *Galt*, 511 F. 2d 504, 510 (7th Cir. 1975); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 235 (2d Cir. 1974).

6. *See, e.g., Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972); *Glen-Arden Commodities, Inc.* v. *Costantino*, 493 F. 2d 1027 (2d Cir. 1974). Similarly, defendants' reference to an absence of an attack by the plaintiffs on the fairness of the stock exchange (Petition, p. 5) is not a relevant consideration to plaintiffs' Section 10(b) action.

7. The district court's opinion, however, is devoid of any discussion as to how or why the Complaint failed to comply with Rule 9(b).

REASONS WHY THE WRIT SHOULD BE DENIED.

A. The Decision Below Was Correct and Does Not Contravene This Court's Decision in TSC Industries, Inc. v. Northway, Inc.

Contrary to defendants' contention the decision below is fully in accord with this Court's decision in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U. S. 438 (1976). In fact, in defining the issue presented by this case, the Second Circuit explicitly employed the standard of materiality as set forth in *TSC*:

> The issue on this Rule 12(b)(6) motion is whether the plaintiffs can prove any set of facts that, had they been disclosed, would have been considered by the reasonable shareholder to have "significantly altered the 'total mix' of information made available." *Id.* [*TSC*] at 449, 96 S. Ct. at 2133.

571 F. 2d at 707 (8a). Applying that standard to the plaintiffs' Complaint, the Second Circuit correctly held:

> The statements about the availability of Rule 144 and the omissions regarding Delaware law raise substantial issues. The statement about the potential availability of Rule 144 could have misled the reasonable shareholder into thinking that it was, in fact, available to him. Similarly, the discussion of the loss of preemptive rights and the discontinuance of cumulative voting as a result of the changeover to Delaware law, could have misled him into thinking that the changeover did not otherwise affect his rights.

Id. (8a-9a.)

Defendants, however, suggest that the Second Circuit's use of the word "could" instead of "would" is an affront to this Court's *TSC* materiality standard and will engender a magnitude of meritless litigation and transform proxy statements into avalanches of trivial information. (Petition, pp. 9-14.) This parade of imaginary horribles understandably ignores the procedural

posture of this case on a motion to dismiss. This Court has held that a complaint will not be dismissed unless it appears to a certainty that the plaintiff is not entitled to relief under any state of facts which could be proven in support of the claim. *See, e.g., Conley* v. *Gibson*, 355 U. S. 41 (1957). Recognizing this long standing rule, the Second Circuit applied the materiality standard in a manner consistent with federal procedure as well as federal securities law,[8] stating:

> On this motion to dismiss for failure to state a claim, plaintiffs' allegations must be accepted as true and must be read in the manner most favorable to them. This is especially true when dealing with questions of materiality which, since they are "mixed questions of law and fact," require
>
> > delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.
>
> *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U. S. 438, 450, 96 S. Ct. 2126, 2133, 48 L. Ed. 2d 757 (1976).

571 F. 2d at 706-707 (8a) (footnote omitted).

The Second Circuit's use of the word "could" rather than "would" only demonstrates the court's cognizance of the procedural posture of the case—defendants sought a determination of the materiality of misstatements and omissions based upon

8. Unlike this case, *TSC* involved a summary judgment motion and very different principles than a motion under Rule 12(b)(6) of the Federal Rules of Civil Procedure. In fact, defendants err in their Petition when they characterize the *TSC* holding as follows:

> [A]n omitted fact is material only if there is a "substantial likelihood that under all circumstances the omitted fact would have assumed actual significance in the deliberations of a reasonable shareholder".

Petition at 9-10. An accurate characterization of this Court's holding is:

> An omitted fact is material *as a matter of law* only if there is a substantial likelihood that under all circumstances the omitted fact would have assumed actual significance in the deliberations of a reasonable shareholder.

See 426 U. S. at 450, 453 (emphasis added).

the Complaint only. Other courts applying the *TSC* standard have also recognized that the materiality test must not usurp the role of the trier of fact.[9] *See Billet* v. *Storage Technology Corp.*, 72 F. R. D. 583, 586 (S. D. N. Y. 1976); *Imperial Supply Co.* v. *Northern Ohio Bank*, 430 F. Supp. 339, 357 (N. D. Ohio 1976). *See also Alton Box Board Co.* v. *Goldman, Sachs & Co.*, 560 F. 2d 916, 922 (8th Cir. 1977); *May Department Stores Co.* v. *First Hartford Corp.*, 435 F. Supp. 849 (D. Conn. 1977).

Moreover, to suggest, as the defendants do (Petition, p. 13), that the Second Circuit's use of "would" is tantamount to an adoption of the prior "might" standard rejected by this Court in *TSC*, ignores the very historical underpinnings of the *TSC* decision. The Second Circuit opted for the "would" standard more than three years prior to this Court's resolution of the conflict among the courts of appeals over the "would" versus "might" standard as this Court observed in *TSC*. *See TSC Industries, Inc.* v. *Northway, Inc.*, 426 U. S. 438, 445, 449 (1976), *citing with approval, Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281 (2d Cir. 1973). *See also Gould* v. *American-Hawaiian S. S. Co.*, 535 F. 2d 761, 770 (3d Cir. 1976). The Second Circuit merely applied its own standard, as ratified by this Court, in disposing of the appeal in this case.

Finally, defendants' contention that the decision below will open the floodgates to meritless securities litigation cannot withstand analysis. As indicated, the Second Circuit's opinion is a well-reasoned decision based upon long-standing legal principles in the securities field and that of federal procedure. Moreover, the decision involves two well-defined factual areas in which the Second Circuit held that a cause of action had been stated: (1) the suggestion of an exemption from registration under the federal securities laws pursuant to Rule 144; and (2) the failure of having disclosed some significant differences on shareholders' rights resulting from the reorganization, to disclose other significant differences or to avoid all reference to any differences.

9. Plaintiffs have demanded a trial by jury. *See* Complaint (25a).

To the extent that analogous situations arise, it is specious to suggest that they will constitute an avalanche. Moreover, contrary to defendants' assertion, the Second Circuit's decision will tend to diminish rather than expand information since the vice in defendants' disclosure was that they said more than what was required out of a desire to further their proposed reorganization. Having done so, it was incumbent upon them to close the disclosure circle. The prudent person who reads the Second Circuit's decision will be less inclined, not more inclined, to include information, trivial or otherwise, that is not material out of a desire to mislead investors.

B. The Second Circuit's Opinion Does Not Conflict with Decisions in Other Circuits.

Defendants assert that the Second Circuit's opinion conflicts with decisions of the Third and Fifth Circuit because of its failure to note two cases cited by the district court, *Ash* v. *LFE Corp.*, 525 F. 2d 215 (3d Cir. 1975); *Vohs* v. *Dickson*, 495 F. 2d 607 (5th Cir. 1974). Those cases, however, are inapposite to this case and the Second Circuit had no reason to discuss them.

Ash and *Vohs* presented a very different legal issue than the one raised by this case. In both cases the courts of appeal were asked to decide whether a material omission resulted from the complete failure of the seller of the securities in question to disclose a "legal theory" or to render "legal advice" to the buyer. In contrast, the issue in this case is whether the Information Statement was misleading in disclosing some of the changes in the stockholders' rights that would occur if the Plan was adopted, but not other changes that might have an adverse effect on the shareholders' control of future important corporate decisions.

Plaintiffs do not contend that defendants had a duty to disclose the differences in the two states' corporation laws. Had the

Information Statement done nothing more than inform the shareholders that the new holding company, JBI, was to be incorporated under the laws of Delaware rather than Illinois where all of the operating companies were incorporated, there would be no claim. Rather, the Complaint alleges that the Information Statement purported to describe the newly-issued stock by disclosing in detail the following differences:

Illinois Law	*Delaware Law*
(a) cumulative voting required	(a) no cumulative voting
(b) preemptive rights	(b) no preemptive rights
(c) dividends paid annually	(c) dividends to be declared and paid at the discretion of the Board

However, the Information Statement failed to disclose the following differences at all:

Illinois Law	*Delaware Law*
(a) two-third voting requirement for mergers, amendments to Articles of Incorporation, dissolution, etc.	(a) simple majority voting requirement for mergers, amendments to Articles of Incorporation, dissolution, etc.
(b) Board vacancies required a vote of shareholders in order to be filled	(b) Board vacancies can be filled by JBI directors without shareholders' approval
(c) appraisal rights for dissenting shareholders	(c) no appraisal rights for dissenting shareholders
(d) limited rights of indemnification for corporate officers and directors	(d) broad rights of indemnification for corporate officers and directors

Such a limited description of the differences in shareholders' rights, in light of the omission of others, was certainly misleading by lulling the investors into believing that all of the pertinent differences had been disclosed. Thus, a partial disclosure of the legal rights of the stockholders, as occurred in this case, presents a very different issue than confronted the *Ash* and *Vohs* courts

where no disclosure whatsoever was made with respect to legal matters.

Not only does this case present a very different legal issue than was raised in *Ash* and *Vohs,* but neither of those cases was decided on a motion to dismiss. Moreover, those cases are factually distinguishable. In *Ash,* the plaintiff alleged that a management proxy solicitation was misleading with respect to a proposed employee pension plan. The claim was premised upon plaintiff's belief that certain of the pension plan's benefits constituted a "gift" under Delaware law and that the proxy failed to clearly disclose the proposed plan's increased benefits for management. Unlike the partial disclosure by the Information Statement in this case, the proxy in *Ash* did state the rate of compensation under both the prior pension plan and the proposed plan. All it failed to do was to make the simple arithmetical computation to show the amount of increase that management would receive if the proposed plan were adopted.

The *Vohs* case was an action by buyers of unregistered stock of their corporate employer against the seller, a co-employee. The seller had no more knowledge of securities law than the buyers and the sale was thus an isolated transaction exempt from Georgia registration requirements. The *Vohs* court specifically held that an "ordinary employee-stockholder is not chargeable with constructive knowledge of financial matters he might have discovered by an expert review of company books." 495 F. 2d at 624. In contrast to the *Vohs* situation, the individual defendants in this case were not ordinary stockholders unknowledgeable of securities law. Rather, they were officers of and legal counsel for JBI who actually prepared the Information Statement. Moreover, William Collier occupied the dual role as counsel for JBI and the personal attorney of plaintiff William Joyce. Clearly, neither the *Ash* nor the *Vohs* decision is in conflict with that of the Second Circuit.

CONCLUSION.

Notwithstanding defendants' rhetoric, this is not a case which warrants the exercise of this Court's discretion in issuing a writ of certiorari. Defendants' quarrel is with the correctness of the decision, but that issue does not warrant review by this Court. In advancing that quarrel they have sought to turn the small rock of this decision below into an avalanche of litigation, and cases involving different legal issues, procedural postures and facts into a conflict in circuits. Their alchemy falls far short of the mark.

It is respectfully submitted that the decision of the Second Circuit holding that plaintiffs have stated a cause of action against defendants under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 faithfully and accurately applied this Court's *TSC* decision. Nothing in the decision below is in conflict with either the *Ash* or *Vohs* decision. The Petition should accordingly be denied.

Respectfully submitted,

DONALD E. EGAN,
LEE ANN WATSON,
KATTEN, MUCHIN, GITLES,
ZAVIS, PEARL & GALLER,
55 East Monroe Street,
Suite 4100,
Chicago, Illinois 60603,
Attorneys for Respondents.

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PETITIONERS' REPLY BRIEF

MICHAEL LESCH
SHEA GOULD CLIMENKO & CASEY
330 Madison Avenue
New York, New York 10017
Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel
MICHAEL LESCH,
SANFORD A. BELL.

Table of Authorities

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PETITIONERS' REPLY BRIEF

Petitioners submit this reply brief in further support of their petition for a writ of certiorari and in reply to arguments raised in respondents' brief in opposition.

Respondents concede that the standard of materiality applied by the Second Circuit below is one which differs from (and, in fact, flatly contravenes) the standard established by this Court in *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438 (1976) (Resp. Br. 6). They attempt to

justify this obvious deviation, as one which is somehow required by "the procedural posture of this case" (Resp. Br. 6).

We do not, however, perceive the slightest indication in *TSC* that this Court intended the standard of materiality under the federal securities laws to be subject to a sliding scale or variable definition dependent on the stage of the litigation.

The standard of materiality which the majority below ultimately relied on, and which respondents argue is correct, focuses on facts which a stockholder "could" conceivably have considered important under some unidentified hypothetical set of circumstances and thus constitutes a formulation "too suggestive of mere possibility, however unlikely" which this Court repudiated in *TSC* (426 U.S. at 449). The Second Circuit decision is grounded on the following speculative conclusion:

> "The statement about the potential availability of Rule 144 *could* have misled the reasonable shareholder into thinking that it was, in fact, available to him. Similarly, the discussion of the loss of preemptive rights and the discontinuance of cumulative voting as a result of the changeover to Delaware law, *could* have misled him into thinking that the changeover did not otherwise affect his rights." (emphasis added.)

The notion of materiality applied by the Court below virtually forecloses pre-trial dismissal of any claim based on alleged misstatements or omissions, no matter how trivial the claim or how remote the likelihood that the shareholder was misled. If not overturned, the majority opinion below will signal to potential litigants that the mere allegation of "material" misstatements or omissions will suffice to preserve an action for trial. The threat of litiga-

tion of such trivial and remote claims will cause corporate management to "bury" stockholders with the very "avalanche[s] of trivial information" which this Court held in *TSC* would subvert the informed decision-making the securities laws are designed to foster.

Respondents seek to justify the loose standard applied by the Second Circuit in this case on the ground that *Conley* v. *Gibson*, 355 U.S. 41 (1957), "held that a complaint will not be dismissed until it appears to a certainty that plaintiff is not entitled to relief under any state of facts which *could* be proven in support of the claim" (Resp. Br. 7, emphasis added). Such a result is certainly not required by this Court's decision in *Conley*.

The *Conley* case merely held that the Rules of Civil Procedure generally permit simplified pleading. However, it is well established that allegations under Rule 10b-5, 17 C.F.R. § 240.10b-5, must comply with the requirements as to particularity of Rule 9(b), Fed. R. Civ. P. *See, e.g. Segal* v. *Gordon*, 467 F.2d 602, 607 (2d Cir. 1972).

And, it is clear that the *TSC* decision in no way rules out the summary disposition of questions of materiality as a matter of law in an appropriate case (426 U.S. at 450). Indeed, in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), this Court, citing *TSC*, upheld the dismissal of a complaint under Section 10(b) of the Securities and Exchange Act and Rule 10b-5 on the ground, among others, that the "failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule" (430 U.S. at 474, n.14).

The several post-*TSC* decisions which respondent cite in support of their contention that allegations of material misstatements and omissions under the securities laws may not be tested prior to trial, simply do not support their position (Resp. Br. 7). Indeed, *Alto... r Board Co.* v. *Goldman, Sachs & Co.*, 560 F.2d 916 (8... . 1977), the

only appellate decision and most recent decision cited by respondents in this regard, makes it clear that issues of materiality may in appropriate cases be resolved as a matter of law. Thus, in *Alton Box,* the Fourth Circuit stated:

> "We come then to the second question: whether this court can say that the undisclosed facts fail to constitute *as a matter of law,* facts which a reasonable investor would consider important in making the decision to purchase the notes in question. This depends, of course, upon the circumstances of the case." (560 F.2d at 920; emphasis in original.)

Respondents' argument is also refuted by the Second Circuit's opinion below which, even while applying the wrong standard of materiality, explicitly affirmed the district court's dismissal of one of respondents' three claims (set forth in ¶¶ 7, 8, 9 10(a) of the complaint, 20a-21a) on the ground that the alleged misrepresentation was not material *as a matter of law.*

The danger of permitting a "could" standard of materiality as applied by the Second Circuit below rather than the "would" standard established by this Court's *TSC* decision is dramatically illustrated by certain concessions respondents make in their opposing brief. Respondents no longer claim that petitioners' statements regarding Rule 144 were misleading but now, in light of the fact that petitioners have pointed out to the Court that the documents annexed to and forming part of respondents' own complaint plainly refute such an assertion (see Pet. for Cert., pp. 5-7), concede that such statements were at most "ambiguous" (Resp. Br. 3). Mere ambiguities, of course, do not amount to misstatements or omissions of facts which "would have assumed actual significance in the deliberations of the reasonable shareholders" and have never been held to be the basis for claims under the federal securities laws.

However, if the "could" standard of materiality applied by the Second Circuit below is permitted to stand, as respondents correctly point out, any allegation of an ambiguity in a disclosure document will now constitute a claim which cannot be disposed of without a trial. Thus, the sliding standard of materiality applied by the Second Circuit below, unless overturned, will result in an unwarranted and ill-conceived expansion of the federal securities laws.

Respondents also concede that petitioners had no duty to make an exhaustive disclosure of the differences between Delaware and Illinois corporation law (Resp. Br. 8-9). They persist, however, in contending that once petitioners elected in an Information Statement to disclose certain significant differences between Delaware and Illinois corporation law relating to newly-issued stock (which indeed promotes the informed decision-making which the securities laws seek to foster), they somehow become duty-bound to provide an exhaustive comparison of all differing provisions between the two laws no matter how insignificant or how remote from any facts alleged in this case.

Respondents' presentation of the disclosed and "undisclosed" differences (Resp. Br. 9) itself demonstrates the absurdity of respondents' position. For example, it *was* clearly important that shareholders voting on the proposed exchange be informed that minority representation could be entirely eliminated by Delaware law (which does not require cumulative voting) and that under Delaware law their dividends could be eliminated in the discretion of the Board of Directors. By contrast, it was wholly inconsequential whether a six month vacancy on the Board of Directors could be filled by the Board or by the shareholders where, as here, plaintiffs occupied a minority position as both board members and shareholders.

Thus, respondents' own presentation (Resp. Br., 9) clearly shows that petitioners set forth in the Information Statement the significant effects upon stockholders' rights resulting from a change from Illinois to Delaware incorporation and that the omitted differences were wholly insignificant. Indeed, respondents do not even pretend that any of the "undisclosed" differences between Illinois and Delaware law were of any significance or attempt to set forth any facts which "could be proven" in support of their claim as alleged in the complaint which would show that the omissions were, in fact, material.

In essence, respondents have sought to rationalize the Second Circuit's decision on the theory that concededly important information must be excluded from disclosure unless a whole host of remotely related insignificant information is also disclosed, stating (Resp. Br., 8-9):

> "Had the Information Statement done nothing more than inform the shareholders that the new holding company JBI, was to be incorporated under the laws of Delaware rather than Illinois where all of the operative companies were incorporated, there would be no claim."

Such a rule will present conscientious corporate managers with the choice of total nondisclosure or exhaustive disclosure with no permissible middle ground. To attempt to avoid frivolous litigation, the corporate managers will inevitably choose to set loose the "avalanche[s] of trival information" which this Court in *TSC* explicitly sought to avoid.

CONCLUSION

For all the reasons urged on behalf of petitioners, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

MICHAEL LESCH
SHEA GOULD CLIMENKO & CASEY
330 Madison Avenue
New York, New York 10017
Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel

MICHAEL LESCH,
SANFORD A. BELL.